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No. 93-695

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Petitioner,

v.

COLUMBIA GAS TRANSMISSION CORPORATION, *et al.*,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether consumers of natural gas that are entitled to protection from unjust and unreasonable rates under a pervasive scheme of federal regulation embodied in the Natural Gas Act should be deprived of millions of dollars in refunds as a result of using state rather than federal common law under the Bankruptcy Code to determine their interest in these federally mandated refunds.

LIST OF PARTIES AND RULE 29.1 LIST

The caption of the decision below, reprinted in Appendix A to the Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit of the Official Committee of Unsecured Creditors of Columbia Gas Transmission Corporation, contains the names of the parties. The Cities of Charlottesville and Richmond, Virginia, own and operate the gas distribution systems serving their respective communities. Neither gas distribution system has a parent or subsidiary company.

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RESPONDENTS' BRIEF IN OPPOSITION

The Cities of Charlottesville and Richmond, Virginia ("Cities"), Respondents in the captioned proceeding, hereby submit this Brief in Opposition to the Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit of the Official Committee of Unsecured Creditors of Columbia Gas Transmission Corporation ("Petitioner" or "Creditors Committee").

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit, reprinted in Petitioner's Appendix A, is reported at 997 F.2d 1039. The order of the United States Court of Appeals for the Third Circuit denying the Creditors Committee's Petition for Rehearing and Rehearing en banc is

reprinted in Petitioner's Appendix D. The opinion of the United States District Court for the District of Delaware, reprinted in Petitioner's Appendix B, is not reported. The opinion of the United States Bankruptcy Court for the District of Delaware, reprinted in Petitioner's Appendix C, is reported at 136 B.R. 930.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1). The judgment of the United States Court of Appeals for the Third Circuit was entered on July 6, 1993. The order of the United States Court of Appeals for the Third Circuit denying the Creditors Committee's Petition for Rehearing was entered on August 6, 1993. The Creditors Committee filed a Petition for a Writ of Certiorari ("Petition") on November 3, 1993. The Cities received the Petition on November 4, 1993. By letter order of William R. Suter, Clerk, dated November 22, 1993, all respondents were granted an extension of time within which to file a response to the Petition, up to and including December 17, 1993.

STATUTES INVOLVED

1. Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, provides in pertinent part:

> (a) The commencement of a [bankruptcy case] . . . creates an estate. Such an estate is comprised of . . . all legal or equitable interests of the debtor in property as of the commencement of the case . . . .
>
> (d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

2. Section 4 of the Natural Gas Act ("NGA"), 15 U.S.C. § 717c, provides in pertinent part:

> (a) Just and reasonable rates and charges. All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission . . . shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.
>
> (e) Authority of Commission to hold hearings concerning new schedule of rates. . . . Where increased rates or charges [become effective pending the completion of a hearing], the Commission may, by order, require the natural-gas company . . . to refund any amounts ordered by the Commission . . . .

STATEMENT OF THE CASE

In 1938, Congress passed the Natural Gas Act ("NGA"). 15 U.S.C. §§ 717-717w. The NGA is "plainly designed to protect the consumer interests against exploitation at the hands of private natural gas companies." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 612 (1944). Respondent Columbia Gas Transmission Corporation ("Debtor") is a natural gas company subject to extensive regulation under the NGA by the Federal Energy Regulatory Commission ("FERC" or "Commission"). On July 31, 1991, Debtor and its parent, The Columbia Gas System, Inc., filed petitions for reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. Sections 1101-1174, in the United States Bankruptcy Court for the District of Delaware.

The question presented here is whether natural gas consumers that the NGA protects are entitled to refunds of millions of dollars in payments made pursuant to FERC orders later found to be unlawful under the NGA. Petitioner — ignoring the clear purpose of the NGA and the important federal interest at

stake — would deprive consumers of the protections provided by the NGA and instead relegate those consumers to the status of "ordinary creditors" under the Bankruptcy Code.

The Third Circuit carefully analyzed the NGA, the Bankruptcy Code, federal common law principles, and the facts, and held that Debtor did not have equitable title to these refunds. Accordingly, the Third Circuit concluded that these refunds are *excluded* from Debtor's bankruptcy estate under Section 541(d) of the Bankruptcy Code, 11 U.S.C. Section 541(d). 997 F.2d at 1062. The Third Circuit's decision is consistent with the consumer protection mandate of the NGA, the Bankruptcy Code, and federal common law principles established by this Court.[1] Petitioner's tortured attempts to discredit the sound reasoning and consistent application of federal law set forth in the Third Circuit's decision and to transform this case into a forum on the application of federal common law, coupled with its studious avoidance of the consumer protection principles of the NGA, warrant denial of its petition.[2]

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[1] In their Cross-Petition for a Writ of Certiorari filed December 3, 1993, the Cities argued that the disposition of the refunds should be governed by the NGA rather than federal common law principles, and that the NGA requires that all of the refunds be flowed through immediately to the customers. This was the analysis adopted by Third Circuit Judge Nygaard in his concurring and dissenting opinion (hereinafter "partial dissent"). The position taken by the Cities in their Cross-Petition does not undermine the Third Circuit majority's conclusion that if trust law governs the dispute over Debtor's interest in the refunds rather than the NGA, then federal common law applies.

[2] Petitioner repeatedly blurs the distinction between the customers of Debtor, which for these purposes are primarily local distribution company ("LDC") customers of Debtor, and the ultimate burner-tip consumers that the NGA is designed to protect. The ultimate burner-tip consumers are the residential, commercial, and other customers of the LDC customers of Debtor. As discussed herein and as the Third Circuit recognized, these consumers are not ordinary creditors for purposes of the Bankruptcy Code; Petitioner's attempt to cast them as such simply ignores over fifty years of regulation under the NGA.

1. *The Federal Interest In The Refunds At Issue.*

Under the NGA, FERC has authority to review and to modify or change rates that do not meet the NGA's just and reasonable standard. 15 U.S.C. § 717c(a). As part of this authority, FERC may allow proposed rates to go into effect subject to refund pending completion of its investigation into the justness and reasonableness of the proposed rate. 15 U.S.C. § 717c(e). The preliminary rates that go into effect pending FERC review and subject to refund are *not* final and do *not* meet the statutorily mandated "just and reasonable" standard. Only when FERC issues a final order concerning those rates, and any refunds of rates previously collected in excess of the just and reasonable level are made to the consumers that paid the unlawful rates, do the rates become final and lawful under the NGA.

FERC's power is not limited to reviewing proposed changes in rates or new rates; FERC may also review contractual terms, existing rates, and practices of companies subject to its jurisdiction. *See* 15 U.S.C. §§ 717c and 717d. As the Third Circuit correctly observed, "[i]f the Commission finds that any rate, contract or practice of a gas company is unjust, unreasonable, unduly discriminatory or preferential, it may determine the reasonable rate, contract term or practice and order the offending company to comply with its determination. *See* 15 U.S.C. § 717d(a)." 997 F.2d at 1052.

This brief summary of FERC's powers and duties underscores the pervasive nature of its regulation of the rates and services of interstate pipelines under the NGA. The refunds at issue here result from FERC's attempt to resolve the so-called "take-or-pay" problem through FERC Order Nos. 500 and 528.[3]

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[3] Approximately $161 million of the refunds at issue in the case relate to the take-or-pay claims. Other categories of refunds at issue include charges collected by Debtor to be turned over to the Gas Research Institute ("GRI") and to certain upstream pipelines of Debtor. This Brief in Opposition focuses solely on the refunds due to Debtor's customers as a result of the take-or-pay

Pipelines such as Debtor entered into long-term contracts with natural gas producers in the late 1970s and early 1980s that required the pipeline to "take" a certain quantity of gas or to "pay" for that quantity even if it actually took less. As the Third Circuit observed:

> By 1987, an oversupply of natural gas significantly decreased market prices, and pipeline customers had little incentive to purchase gas from pipelines at prices sufficient to allow the pipelines to cover the cost of gas they agreed to pay in their take-or-pay contracts. As a result, pipelines' gas sales declined, and the pipelines faced billions of dollars in accrued and future take-or-pay liability.

Id.

FERC's initial response to the take-or-pay problem, as set forth in its Order No. 500, was to permit pipelines to buy out or buy down their take-or-pay contracts and to "equitably" allocate the costs of the buyouts and buydowns among pipelines, producers, and pipeline customers. *See Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 52 Fed. Reg. 39,334, FERC Stats. & Regs. (CCH) ¶ 30,761 (1987) ("Order No. 500"), *remanded, American Gas Ass'n v. FERC*, 888 F.2d 136 (D.C. Cir. 1989). If a pipeline was willing to absorb between twenty-five and fifty percent of these costs, it could "pass through" to its customers an equal portion of the costs through a fixed charge. *Id.* at 30,784-85. The fixed charge to be assessed to each pipeline customer was determined by way of the "purchase deficiency methodology" under which each pipeline customer was allocated a portion of these costs based on the decline in that customer's pipeline gas purchases over a relevant period. *Id.* at p. 30,785. In addition, pipelines were also allowed to recover in full from their LDC customers (and

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claims; the Third Circuit also found Debtor did not have an equitable interest in funds collected on behalf of GRI.

ultimately from the burner-tip consumers they serve) the take-or-pay costs allocated to them under the purchase deficiency methodology by their upstream pipeline-supplier(s). *Id.* at 30,791. Thus, under Order No. 500, customers such as the Cities were presented a direct bill for (1) a portion of the take-or-pay costs incurred directly by Debtor and (2) take-or-pay costs assessed to Debtor by its various upstream pipeline-suppliers.

The latter category of costs is at issue in this proceeding. Debtor was billed a certain amount by each of its upstream pipeline-suppliers, which it in turn billed to each of its customers, including the Cities. Each customer paid that amount to Debtor, which simply turned it over to the upstream suppliers. Stated differently, Debtor acted as a conduit for payments by its customers to its upstream suppliers, merely passing through dollars paid by Debtor's customers to the upstream pipeline-suppliers and *vice versa*. These dollars, to which Debtor has no equitable right, claim, or entitlement, are the dollars that Petitioner incorrectly contends are part of the property of Debtor's estate.

The United States Court of Appeals for the District of Columbia Circuit struck down the FERC Order No. 500 purchase deficiency methodology for allocating costs among pipeline customers on the ground that it imposed a retroactive rate increase on certain of those customers in violation of the NGA. *Associated Gas Distributors v. FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied*, 498 U.S. 907 (1990).[4] In response, FERC

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[4] Petitioner notes that the District of Columbia Circuit vacated the cost allocation mechanism "*not* because the charges were deemed excessive or unreasonable, but because this after-the-fact allocation violated the technical prohibition against 'retroactive ratemaking.'" Petition at 5 (emphasis in original) (citations omitted). Apparently, Petitioner is trying to distinguish the refunds ordered as a result of the *Associated Gas Distributors* case from refunds ordered when a rate is found to be excessive. This is a distinction without a difference. The fact that Order No. 500 was found to violate the prohibition against retroactive ratemaking goes to *why* it is excessive and

issued Order No. 528, which required pipelines to file new tariffs that allocate the take-or-pay charges to their customers pursuant to a different allocation method, and to refund the amounts customers were overcharged under the Order No. 500 purchase deficiency methodology. *See Mechanisms for Passthrough of Pipeline Take-or-Pay Buyout and Buydown Costs*, 53 FERC (CCH) ¶ 61,163 (1990) ("Order No. 528"), *reh'g denied in part, granted in part*, Order No. 528-A, 54 FERC (CCH) ¶ 61,095 (1991), *reh'g denied*, Order No. 528-B, 55 FERC (CCH) ¶ 61,372 (1991).

Pursuant to Order No. 528, five upstream pipelines that supplied gas to Debtor filed new rate schedules; the change in allocation methods used in these schedules resulted in $161 million in refunds to Debtor's customers to compensate for the amounts that its customers were overcharged under the Order No. 500 purchase deficiency methodology. Under the terms of Order No. 528 and its FERC Gas Tariff, Debtor again functions as a conduit and is *required* to pass these "take or pay" refunds through to its customers that paid the overcharges to Debtor. Order No. 528, 53 FERC at 61,596 ("all refunds must be paid by upstream and downstream pipelines to the customers that actually paid the fixed charges").

Pursuant to FERC Order No. 500, when Debtor was presented a bill for these costs by its upstream pipeline-suppliers, it simply allocated those costs to its LDC customers, collected them, and turned them over to the upstream pipelines. Likewise, when the United States Court of Appeals for the District of Columbia Circuit reversed FERC Order No. 500, refunds from the upstream pipeline-suppliers were and are to be flowed through by Debtor to *the LDC customers that paid those costs*

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must be refunded under the NGA, not *whether* it is excessive. The NGA requires that rates be "just and reasonable" — a rate that violates the prohibition against retroactive ratemaking is unjust and unreasonable and is excessive as to those customers that were overcharged.

in the first place. Under the terms of the NGA, FERC Order Nos. 500 and 528, and Debtor's FERC Gas Tariff, Debtor had and has *no* equitable claim, title, or interest in either the payments or the refunds. As the Third Circuit held, under the federal common law of trusts, Order Nos. 500 and 528 created a constructive trust for these dollars for the benefit of Debtor's customers, and established Debtor (the conduit for the FERC-ordered payments and refunds) as trustee. 997 F.2d at 1059-62.

The payments and refunds at issue constitute a component of the rate paid by Debtor's customers and are thus subject to the NGA's mandate that rates be just and reasonable. If the refunds are not returned to Debtor's LDC customers on behalf of the consumers they serve, the rate paid by those customers will be unjust and unreasonable in direct contravention of the NGA, FERC Order Nos. 500 and 528, and Debtor's FERC Gas Tariff.[5] Debtor simply does not have any equitable title to the dollars at issue here; hence, under Section 541(d) of the Bankruptcy Code, these dollars should be returned to Debtor's LDC customers.

2. *The Bankruptcy Code.*

The Bankruptcy Code governs the priority of payment of claims against the property of a bankrupt. Where, as here, property is not part of the bankrupt's estate, that property is not

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[5] Petitioner asserts that "it is well established that Congress' purpose in enacting the NGA was limited to protecting gas consumers from *monopoly power*, not protecting gas distribution companies from the ordinary risks of bankruptcy . . . faced by all commercial entities." Petition at 16 (emphasis in original) (footnote omitted). Petitioner fails to mention that Congress' method for protecting gas consumers from that monopoly power was to ensure the availability of adequate supplies of natural gas at just and reasonable rates. *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). This federal statutory purpose would be thwarted if refunds ordered by FERC as part of its authority to ensure that rates are just and reasonable were kept from customers because under a particular state's law the refunds do not meet the definition of a trust held on behalf of the customers.

subject to the priority payment scheme established by the Bankruptcy Code and may be dispensed without regard to the priority rights of both unsecured and secured creditors. 11 U.S.C. § 541(d). Under Section 541, "[p]roperty in which the debtor holds . . . only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold." 11 U.S.C. §541(d). As demonstrated above, under the facts of this case, Debtor does not hold *any* equitable title in the refunds of take-or-pay charges.

Petitioner argues for a narrow and unsupportable view of Section 541(d), contending that only property meeting the definition of a trust under state law qualifies for the exemption of property from a debtor's estate. Petitioner's view is contrary to both (1) Section 541(d) itself, which addresses legal and equitable title in general and does not directly address the trust issue, and (2) a long line of precedents that have applied the federal common law of trusts to the determination of property interests of a bankrupt when there is a strong federal interest at stake. *See, e.g., In re Lehigh & New England Ry.*, 657 F.2d 570 (3rd Cir. 1981) and *In re Penn Central Transp. Co.*, 486 F.2d 519 (3rd Cir. 1973) (en banc), *cert. denied*, 415 U.S. 990 (1974) (extensive federal regulation of interline railroad system justified applying federal law); *In re United Milk Products Co.*, 261 F. Supp. 766 (N.D. Ill. 1966) (government's interest in federally administered milk price support program called for application of federal law); *see also Butner v. United States*, 440 U.S. 48, 55 (1979) ("federal interest" can require the application of federal law to the determination of property interests).

The federal interest in this case is remarkably clear. Consumers are entitled to protection from unjust and unreasonable rates under the NGA; the failure to return the dollars at issue

here clearly would violate that interest. Thus, the federal common law should be applied to determine whether a trust exists.

3. *The Decisions Below.*

The Bankruptcy Court correctly applied the federal common law of trusts and found that the customer refunds were held in trust by Debtor for its customers. Thus, because these refunds are not part of Debtor's estate, they must be flowed through to Debtor's customers without regard for the priority rights of Debtor's creditors. The United States District Court for the District of Delaware incorrectly reversed the Bankruptcy Court's finding and instead applied state common law, concluding that no trust existed between Debtor and its customers with respect to the refunds. The Third Circuit reversed the District Court, agreeing with the Bankruptcy Court that federal common law should determine the existence of a trust and that under federal common law the customer refunds are held in trust by Debtor for its customers.

SUMMARY OF OPPOSITION

Despite the existence of a pervasive scheme of federal regulation under the NGA, despite the fact that Debtor acted as a mere conduit, passing payments and refunds between upstream pipeline suppliers and Debtor's LDC customers, and despite the Third Circuit's well-reasoned decision and attention to the particular facts of this case, Petitioner challenges the Third Circuit's holding that federal law governs the disposition of the refunds.[6] This Court should deny Petitioner's request for a writ

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[6] Petitioner cites the concurring and dissenting opinion's observation that "'nothing indicates one way or the other whether the parties intended to create a trust' and '[n]one of the traditional indicia of a trust relationship . . . [was] present.'" Petition at 7 (*quoting* 997 F.2d at 1064 (Nygaard J., concurring and dissenting)). Petitioner's citation to the partial dissent to support its position is disingenuous. The partial dissent does *not* support Petitioner's position at all; instead, that opinion found that *all* of the refunds at issue here (both pre- and post- petition) should be returned to Debtor's customers

of certiorari because Petitioner has (1) failed to demonstrate that the Third Circuit incorrectly applied federal common law to a situation involving an important federal interest, *i.e.*, the protection of consumers under the NGA; (2) failed to identify any *bona fide* conflict in the decisions of various circuits that would affect the outcome of this case; and (3) failed to demonstrate that an important issue is at stake in this proceeding that requires review by this court.

REASONS FOR DENYING THE PETITION

Petitioner frames the issue presented in this case as:

> Whether Congress has authorized federal courts in making property rights determinations concerning federally-regulated bankrupts to preempt the established state trust and property law called for by the Bankruptcy Code in favor of newly-created federal common law designed to further generalized policy interests unrelated to bankruptcy.

Petitioner has mischaracterized the issue in this case and misrepresented the holding of the Third Circuit as well as prior decisions of this Court and other federal courts.

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because, under the NGA, Debtor has no equitable interest whatsoever in these refunds. 997 F.2d at 1065-66 (Nygaard, J., concurring and dissenting) ("[The refunds] were ordered by a federal agency empowered by Congress; they must be passed through to the customers lest the holder violate the law; therefore, they belong solely to the customers under federal law."). That opinion reasoned that trust law, whether state or federal, is therefore irrelevant to the disposition of the refunds. *Id.* at 1064 (Nygaard, J., concurring and dissenting) ("[W]e should not apply traditional trust law in an area that is clearly unsuited for its application."). As noted *supra*, n.1, the Cities agree with the partial dissent that the NGA should determine Debtor's interest in the refunds. Nonetheless, if trust law governs the dispute, the Third Circuit majority is correct that federal common law must be applied.

Petitioner argues that the Third Circuit's decision goes beyond established precedents and creates a new rule of federal common law that threatens to undermine the policies furthered by the Bankruptcy Code. To the contrary, however, the decision below faithfully applies the federal common law jurisprudence of this Court and the established precedents concerning the application of the federal common law of trusts to the narrow question of whether customer refunds ordered by FERC pursuant to its authority under the NGA and merely flowed through by Debtor to those customers constitute part of Debtor's estate under the Bankruptcy Code.

At the outset, Petitioner's arguments should be rejected because Petitioner simply misconstrues the Bankruptcy Code. Had Debtor not declared bankruptcy, then Debtor would have had no equitable claim to these refunds. Under the NGA, the refunds belong to the customers and Debtor has no equitable interest in them. FERC and its predecessor, the Federal Power Commission ("FPC"), have consistently refused to allow pipelines to assert any claims against upstream pipeline-supplier refunds in their possession. *See, e.g.*, Order No. 528, 53 FERC at p. 61,596 ("all refunds must be paid by upstream and downstream pipelines to the customers that actually paid the fixed charges"); *Texas Eastern Trans. Corp.*, 39 FPC 630, 637-38 (1968) (holding that under the NGA "the ultimate consumers of natural gas are proper beneficiaries" of refunds from gas suppliers and that an interstate pipeline "has no legal right thereto"), *aff'd sub nom., Texas Eastern Transmission Corp. v. FPC*, 414 F.2d 344 (5th Cir. 1969), *cert. denied*, 398 U.S. 928 (1970). Since the refunds were ordered to remedy a rate found to be in violation of the NGA, they belong to the customers that paid the unlawful rate in the first place.

Despite this clear precedent, Petitioner argues that Debtor acquired some sort of equitable interest in the refunds as a result of its bankruptcy. That conclusion cannot be correct because

the Bankruptcy Code does *not* create any substantive property rights, it only creates a set of procedures for dealing with Debtor's property. *See, e.g., In re Nejberger*, 934 F.2d 1300, 1302 (3rd. Cir. 1991); *In re Farmers Markets, Inc.*, 792 F.2d 1400 (9th Cir. 1986); *L. King, Collier on Bankruptcy*, ¶ 541.02[1] (15th ed. 1993) ("Section 541 of the Code . . . provides a system for dealing with the debtor's interest in property and his debts. However, the existence and nature of the debtor's interest in property, and of his debts, are determined by non-bankruptcy law."); *see also*, 997 F.2d 1066 (Nygaard, J., dissenting and concurring). Petitioner seeks access to property to which Debtor would not be entitled had it not filed for bankruptcy, thereby arguing that the Bankruptcy Code has somehow created a new substantive property right. This is flatly contrary to the policy behind the Bankruptcy Code. For this reason alone, the Petition should be rejected.

Petitioner essentially advances three arguments in support of its Petition: (1) the Third Circuit's decision goes beyond established precedents of this Court concerning when federal common law should be applied; (2) there is a split in the circuits concerning the treatment of claims against federally regulated bankrupts; and (3) the issue in this case is of great importance. Even a cursory analysis of the facts, the NGA, the Bankruptcy Code, the relevant precedents, and the Third Circuit's decision demonstrates that none of these arguments is meritorious and that the writ therefore should be denied.

1. *The Third Circuit's Decision Properly Applies Federal Common Law To The Unique Facts And Circumstances Of This Case.*

Petitioner asserts that the decision of the Third Circuit "goes well beyond the narrow grounds under which this Court previously has permitted the creation of federal common law." Petition at 14. To the contrary, the Third Circuit's decision

faithfully applies the precedents of this Court. Moreover, those precedents compel the conclusion reached by the court below.

Contrary to Petitioner's assertions, the court below did not apply "newly-created federal common law." Petition at (i). Rather, the Third Circuit applied the federal common law of trusts as applied in a long line of precedents. *See, e.g., In re Penn Central Transp. Co.*, 486 F.2d 519 (3rd Cir. 1973) (en banc) *cert. denied*, 415 U.S. 990 (1974); *In re United Milk Products Co.*, 261 F. Supp. 766 (N.D. Ill. 1966). As the Third Circuit observed, "this court already has developed federal common law concerning trusts. Therefore, our decision to apply federal common law will not require us to announce new doctrines of substantive law unforeseen by the parties." 997 F. 2d at 1056 (citations omitted).

Despite this clear conclusion, Petitioner argues that the Third Circuit's decision is "inconsistent with" prior decisions of this Court limiting the scope of federal common law, cautioning courts applying federal common law to incorporate state law where possible, and refusing to apply federal common law "'unless that was the clear and manifest purpose of Congress." Petition at 9 (*quoting Hillsborough County v. Automated Medical Labs., Inc.*, 471 U.S. 707, 715 (1985) (citations omitted)). According to Petitioner, the Third Circuit went beyond Supreme Court federal common law jurisprudence by "sanction[ing] federal common law preemption on nothing more than an unsupported inference that Congress (and the FERC), *had they considered the issue*, would have excused state-regulated gas distribution companies from the traditional principles of property and trust law that govern all other creditors' relationships with bankrupt gas pipelines." Petition at 15 (emphasis in original). Petitioner's characterization of the Third Circuit's holding bears no resemblance to reality.

In *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1975), this Court established a three step analysis to determine

whether federal or state law should supply the rule of decision under a federal statute when Congress has been silent on the issue. The *Kimbell Foods* analysis requires that courts consider the following in determining whether to apply federal common law: (1) the need for a nationally uniform law; (2) whether applying state law would frustrate specific objectives of the federal statute at issue; and (3) the extent to which application of a federal rule would upset commercial expectations that state law would govern. *Id.* at 728-29. A proper application of the *Kimbell Foods* analysis to the particular facts and circumstances of this case, assuming that trust theory is applicable, leads to the conclusion that given the existence of the NGA, federal common law governs the determination of Debtor's property rights in the FERC-ordered refunds at issue in this case.

The Third Circuit adopted the *Kimbell Foods* analysis and painstakingly applied it to the facts and circumstances of this case. 997 F. 2d at 1055. The Third Circuit first found that a national uniform law with respect to the treatment of FERC-ordered customer refunds is necessary "[b]ecause the refunds arise directly from federal law and implement the central objective of the NGA." *Id.* As discussed above, Congress intended, and this Court has recognized, that the NGA would provide uniform regulation of interstate pipelines at the federal level to protect consumers by ensuring that those consumers pay just, reasonable, and non-discriminatory rates. *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 612 (1944).

The Third Circuit further found that the disposition of the refunds "should not be subject to the vagaries of state trust law." *Id.* (citations omitted). Again, the Third Circuit is on solid ground; Debtor operates in a number of different states, including, *inter alia*, West Virginia, Virginia, Maryland, Delaware, Pennsylvania, Ohio, Kentucky, and New York. Each of those states has individual trust laws that were not designed to address the disposition of refunds under the NGA. If not treated uni-

formly under federal common law, the question of whether refunds are the property of consumers that the NGA protects might be decided differently depending on which state law applies.

Moreover, as the Third Circuit also found:

> Trust law in numerous states imposes a constructive trust on funds only if wrongdoing has resulted in unjust enrichment . . . . Absent an express trust or affirmative wrongdoing, state law would not hold the refunds in trust on behalf of Columbia's customers. . . . Federal common law imposes a trust when an entity acts as a conduit, collecting the money from one source and forwarding it to its intended recipient.

Id. at 1056 (citations omitted). This is the essence of the instant case. Petitioner has all but ignored the NGA and the comprehensive regulation of Debtor's activities pursuant to that statute, and would have this Court believe that Debtor's customers are nothing more than ordinary creditors, buying and selling goods and services from and to Debtor. Petitioner is wrong. For the reasons set forth above, the Third Circuit's conclusion that uniform national treatment of these refunds is required is unassailable.

The Third Circuit next concluded that applying state law in this case "would frustrate the NGA's central purpose, to provide natural gas to the public at reasonable rates." 997 F.2d at 1056 (citations omitted). As explained above, while entitled to protection from unlawful rates under the NGA's scheme, customers have no choice but to pay certain rates *subject to refund in the event that those rates are found to be unlawful under the NGA*. That is precisely what occurred here; Debtor's customers were required to pay take-or-pay costs to Debtor's upstream pipeline-suppliers. Later, those rates were found to be unlawful by the United States Court of Appeals for the District

of Columbia Circuit; hence they *must* be returned to customers under the NGA. Any other result simply renders the NGA — and the consumer protections contained therein — a nullity. Given this, Petitioner's argument that "[a]t bottom, *no* substantial federal interest is furthered by abandoning established state law trust principles here," Petition at p. 19 (emphasis in original), is simply incomprehensible.

Nothing in the language of Section 541(d) of the Bankruptcy Code requires the application of state law to determine property interests. By its terms, Section 541(d) exempts "[p]roperty in which the debtor holds . . . only legal title and not an equitable interest." 11 U.S.C. Section 541(d). While state law *generally* governs property determinations under Section 541(d), there are circumstances which call for the application of federal law to determine the property interests of a bankrupt. *See, e.g., In re Roach*, 824 F. 2d 1370, 1374 (3rd Cir. 1987) (*quoting Butner v. United States*, 440 U.S. 48, 57 (1979)) ("[A]bsent a countervailing federal interest, 'the basic federal rule is that state law governs.'") The facts and circumstances of this case, which involves pervasive federal regulation of Debtor under the NGA by FERC, call for the application of federal law to determine the property interests of Debtor in these refunds. Application of state law would deprive consumers of the very protections that the NGA was designed to provide them.

Finally, the Third Circuit found that applying federal common law would not upset commercial expectations that state law would govern, because "[c]reditors cannot reasonably assume that state law will allocate various parties' interests in federally created property rights." 997 F.2d at 1056. Again, the Third Circuit is on solid ground. As discussed above, Debtor's customers are entitled to these refunds under the NGA; in the absence of the NGA, these rights would not exist, just as Debtor's responsibility to collect the payments and to funnel them to upstream pipeline-suppliers in the first place would not

have existed. Petitioners and other creditors are or should be aware that Debtor's activities are regulated under the NGA by FERC.

In short, contrary to Petitioner's assertion, the Third Circuit did not rely on an "unsupported inference" that had Congress considered this issue, it would have exempted bankrupt natural gas companies from application of state trust law. Congress' clear and unequivocal intent in enacting the NGA was to protect natural gas consumers by requiring that rates be just and reasonable, as both this Court and the Third Circuit have recognized. The Third Circuit correctly found that this purpose would be frustrated if customer refunds ordered by FERC to remedy an unjust and unreasonable rate were withheld from customers:

> If FERC intended that [Debtor] act as a conduit for the refunds to reach the public, but state law would not create a trust, FERC's objective of ensuring that exploited customers receive the full amount of their refunds would be subverted by state law. Application of the federal common law rule is necessary to prevent such an outcome.

Id.

Petitioner's only response — albeit both misleading and incorrect — to the conclusion that the NGA's consumer protection mandate would be thwarted by application of state trust law is that "it is gas distribution *corporations*, and *not* the gas-consuming public, that seek the disputed funds." Petition at 16, n. 17 (emphasis in original). As Petitioner knows, Debtor's LDC customers are required by their respective state regulatory commissions to return these refunds to their residential, commercial, and other customers. Moreover, as Petitioner also knows, both state consumer advocate offices and state public utility regulatory commissions of several states were parties to the case below, are respondents to this very petition, and represent the interests of these ultimate burner-tip consumers. These state

parties have fought vigorously for the return of these refunds to the LDCs, which in turn will return them to their customers.

Petitioner's claim that "*nothing* prevents the respondent state public utility commissions from ordering those large corporations to accept the consequences of their decisions to do business with Debtor and immediately refund to the gas-consuming public any amounts that those consumers were overcharged,"[7] Petition at 16, n. 17 (emphasis in original), is disingenuous. Petitioner is or should be aware that prior to November 1, 1993, Debtor's LDC customers had little choice but to purchase some or all of their gas from Debtor.[8] Thus, the "decision to do business with the debtor" was not solely within an LDC's control; Debtor had a monopoly, and LDCs were required to do all or part of their business with Debtor.

As stated by the Third Circuit, "the very purpose of the NGA is to supersede private contractual arrangements that interfere with the federal objective of ensuring that pipelines charge only reasonable rates." 997 F.2d at 1055. As discussed above, LDC customers must rely on the NGA and FERC to protect them in their business transactions with Debtor. Debtor's customers were *required* to pay the take-or-pay surcharges initially accepted by FERC under the NGA. Now that those surcharges have been found to be unjust and unreasonable,

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[7] Petitioner's characterization of Debtor's customers as "large corporations" is a weak attempt to divert the Court's attention from the consumer protection issues at stake. The refund dollars at issue here were paid by the gas consuming public, and the purpose of the refunds ordered by FERC is to return those dollars above the just and reasonable rate level to the gas consuming public. Moreover, not all of Debtor's customers are large corporations. Some of Debtor's customers are small gas distribution systems and some, like the Cities, are publicly owned systems.

[8] For some of the distributors, such as Respondent City of Charlottesville, Debtor is the *only* interstate natural gas pipeline that serves their community, and for other distributors, such as Respondent City of Richmond, Debtor is the major pipeline that serves their community.

it is unfair — not to mention unlawful — to find, as Petitioner argues, that those LDC customers and the consumers they serve are not entitled to the return of those unlawful overpayments because they supposedly should have known better than to deal with Debtor, even though Debtor was the only (or the primary) game in town. Petitioner's misguided attempt to compare Debtor's customers to other large corporations that operate in unregulated competitive markets only highlights the importance of considering the policy objectives of the NGA in determining property rights determinations under the Bankruptcy Code.

2. *There Is No Split In The Circuits Concerning The Appropriate Law To Apply To This Debtor.*

Petitioner contends that there is a split between the Third and Seventh Circuits concerning the treatment of claims against the estate of federally regulated bankrupt "interline" railroads. Petitioner asserts that (1) in *In re Lehigh & New England Ry.*, 657 F.2d 570 (3rd Cir. 1981), and *In re Penn Central Transp. Co.*, 486 F.2d 519 (3rd Cir. 1973) (en banc), *cert. denied*, 415 U.S. 990 (1974), the Third Circuit has established a rule with respect to claims against a bankrupt party subject to any federal regulation under which "federal law now will *always* preempt state law," Petition at 14 (emphasis in original), and (2) in *In re Iowa R.R.*, 840 F.2d 535 (7th Cir.), *cert. denied*, 488 U.S. 899 (1988), the Seventh Circuit has established a rule whereby "federal law will rarely, if ever, preempt state trust law," Petition at 14.

Contrary to Petitioner's assertion, *Penn Central*, *Lehigh*, and *In re Iowa* did not establish broad rules governing *all* claims against *any* federally-regulated bankrupt. Instead, each of these decisions addressed the narrow issue of how to treat the assets of bankrupt interline railroads and applied only to the narrow interline trust context. Petition at 13. While the Third and Seventh Circuits reached different conclusions with respect to this narrow issue, none of these decisions directly addressed the

issue in this case: whether FERC-ordered refunds made pursuant to the NGA are part of a debtor's estate under the Bankruptcy Code. As the Third Circuit explicitly found here, the facts in this case present a more compelling case for applying federal law than the interline railroad context, because "[t]here is an even greater federal interest in this case than in *Lehigh* . . . . The intricate system of accounts pipelines maintain to track refunds, the backbone of the federal scheme to regulate the gas industry, is mandated by federal law. In contrast, the railroads in *Lehigh* voluntarily adopted the interline balance system." 997 F.2d at 1057 (citation omitted). The Third Circuit's decision was limited to the particular facts of this case, facts that state a more compelling case for applying federal law than *Penn Central* or *Lehigh*. Thus, the Third Circuit's decision does *not* broaden the rules governing claims against a federally regulated bankrupt but rather is well within established precedents.

Assuming *arguendo* that the Third and Seventh Circuit decisions cited by Petitioner evidence a split in the interline railroad context, Petitioner has failed adequately to explain why this Court should grant certiorari now, when it has previously declined to review the issues presented in those cases. Although Petitioner claims that this "split" in the circuits is now ripe for review because "the [Third Circuit] court of appeals extended the application of federal trust law well beyond the narrow interline trust context," so that "[i]t is now available in all bankruptcies of federally regulated entities," Petition at 13, Petitioner provides no citation to the Third Circuit decision to support its interpretation of the court's holding. Nor could it. As discussed above, the Third Circuit carefully circumscribed its holding to the unique facts and circumstances of this case and made the required findings under *Kimbell Foods*.

The Third Circuit stated that while federal law governs questions involving the interpretation of a federal statute, "courts may either fashion a uniform federal common law rule

or adopt state law as the federal rule of decision." 997 F.2d at 1055. Applying this principle, the Third Circuit undertook a *Kimbell Foods* analysis of whether state or federal law should supply the rule of decision in this case. The Third Circuit's holding, accurately stated, is that it is appropriate to apply federal common law to the facts and circumstances of this case, *i.e.*, under the NGA, there is a sufficient interest to warrant the application of federal law. *Id.* Nowhere does the Third Circuit indicate that its holding should be applied in any other context, much less to *all* bankruptcies of entities that are in some way touched by federal regulation or *all* trust determinations pursuant to Section 541(d) of the Bankruptcy Code. The Third Circuit's decision is clearly limited to the facts and circumstances of this case and cannot be construed as a general rule of law applicable to all industries subject to some form of federal regulation.

3. *Petitioner Has Failed To Identify An Issue Of Importance That Should Be Addressed By The Court.*

Petitioner's final argument in support of its Petition is that the issue in this case is of "tremendous practical importance," Petition at 17, in light of the number of federally regulated industries. Petitioner claims that the decision below: (1) "has greatly upset established government and commercial expectations of pipeline creditors and others;" (2) will have a "dramatic" adverse impact on the Bankruptcy Code's "orderly process for the fair distribution of the bankrupt's assets;" and (3) "leaves *all* creditors of federally-regulated entities helpless to anticipate the extent of the assets that will be available in the event of bankruptcy." Petition at 17-18 (footnotes omitted) (emphasis in original).

Hyperbole aside, as already demonstrated above, Petitioner's fears are unfounded. *First*, rather than wreak havoc on the order the Bankruptcy Code strives to attain, application of federal trust law in this instance will do no violence to and is

consistent with the goals of the Bankruptcy Code. All parties, including each member of the Creditors Committee, are or should be aware of the nature of federal gas regulation under the NGA. A simple reading of the NGA leaves no doubt that a FERC-regulated pipeline is subject to pervasive federal regulation and has a refund obligation imposed by the NGA. In fact, contrary to Petitioner's assertion, withholding refunds from the customers to whom they belong would undermine the entire premise of the NGA, thereby wreaking havoc on the natural gas industry. Under Section 541(d) of the Bankruptcy Code, creditors have no reasonable expectation that they will have access to funds to which Debtor does not hold equitable title and which Debtor has no reasonable expectation of keeping. The Third Circuit's decision does no more than properly enforce Section 541(d) by recognizing that Debtor has no equitable interest in the refunds under the NGA.

Petitioner claims that the expectations of creditors and others will be upset because "[a]ll prior decisions by the FERC and the Third Circuit . . . indicated that a pipeline's refund obligations could only be classified as unsecured debt." *Id.* at 17 n. 18 (citations omitted). Neither *Penn Central* nor *Lehigh*, both cited by Petitioner, provide any support for this assertion. Those decisions do not even mention pipeline refunds required under the NGA.

Moreover, the only "FERC" decision cited by Petitioner to support its unsupportable proposition is a decision by FERC's Director of the Office of Pipeline and Producer Regulation, *Transamerican Natural Gas Corp.*, 41 FERC (CCH) ¶ 62,206 (1987) that was not even reviewed by the Commission. It is telling that Petitioner could not find a single decision by the Commission itself to support its contention about what "FERC's expressed policy has always been." Petition at 15 n.15. The Director's decision should be taken for what it is, a denial of a company's request that it be granted an extension of time and

not a treatise on bankruptcy law. While the Director mentioned bankruptcy law in passing, neither he nor the FERC has decided that NGA refunds are unsecured debt under the Bankruptcy Code. In fact, the Director concluded that "there is no conflict between the continuation of [the company's] refund obligation and its Chapter 11 status," and ordered the company to pay refunds owed to its customers. 41 FERC at 63,454. The Director simply suggested that the parties go to the bankruptcy court to obtain a determination of these interests, *id.*, which is precisely what Debtor did here. Thus, Petitioner has not cited a single instance in which FERC has held that a pipeline's refund obligations are unsecured debt under the Bankruptcy Code.

Second, rather than having a "dramatic" impact on the Bankruptcy Code's process for determining priorities, the Third Circuit's decision will have *no* impact on that process. The Third Circuit rejected this same argument when raised by Petitioner below, stating that "the Creditors Committee overlooks the dispositive question. The issue before us is whether the refunds are property of the bankruptcy estate. If the refunds are excluded from the bankruptcy estate, the priority scheme is not implicated because it only controls how to divide assets contained in the bankruptcy estate." 997 F.2d at 1058 n. 6.

Third, Petitioner is hardly left "helpless" by the Third Circuit's decision. Petitioner has many other assets to look to in order to satisfy its claims against Debtor. What Petitioner seeks here is unlawfully to increase the assets to which it may lay claim by ignoring the mandate of the NGA that consumers are to be protected. The Third Circuit's decision does not apply to all assets of Debtor; it is strictly limited to FERC-ordered customer refunds under the NGA (and GRI charges).

To be sure, there is an important interest in this case, an interest that the Third Circuit correctly recognized. That interest is to assure consumers that they will not be charged unlawful rates under the NGA. Refunds of unlawful rates are *not* the

property of Debtor; they belong to the consumers that were forced to pay the unlawful rates in the first place. Petitioner's arguments would undermine this long-standing federal regulatory scheme and should therefore be rejected, particularly in light of the fact that the Bankruptcy Code explicitly recognizes that creditors have no right whatsoever to property to which Debtor does not have equitable title.

CONCLUSION

Petitioner has mischaracterized the decision of the Third Circuit, misconstrued other relevant precedents, distorted the facts, and engaged in baseless assertions concerning the Third Circuit's opinion. As demonstrated above, the Third Circuit's decision properly was based on the federal common law jurisprudence of this Court and the prior decisions of other federal courts construing the federal common law of trusts, and is consistent with the policies furthered by the NGA and the Bankruptcy Code.

The Petition for a Writ of Certiorari therefore should be denied.

Respectfully submitted,

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